IN THE INTERMEDIATE COURT OF APPEALS OF WEST VIRGINIA

NO. 23-ICA-327

J.F. ALLEN COMPANY,

Petitioner Below, Petitioner,

v.

MATTHEW R. IRBY, STATE TAX COMMISSIONER OF WEST VIRGINIA,

Respondent Below, Respondent,

On Appeal from the West Virginia Office of Tax Appeals,
Docket No. 21-169 (A.M. "Fenway" Pollack, Chief ALJ)

RESPONDENT'S BRIEF AND CROSS-ASSIGNMENT OF ERROR

PATRICK MORRISEY
ATTORNEY GENERAL

Sean M. Whelan (WVSB # 12067)
Deputy Attorney General
Kevin C. Kidd, (WVSB # 13642)
Assistant Attorney General
State Capitol Complex
Building 1, Room W-435
Charleston, West Virginia 25305
Email: Sean.M.Whelan@wvago.gov
Kevin.C.Kidd@wvago.gov
Telephone: (304) 558-2522
Facsimile: (304) 558-2525

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases Page(s)

Statutes

Rules

Regulations

CROSS-ASSIGNMENT OF ERROR

The West Virginia Office of Tax Appeals ("OTA") correctly held that materials J.F. Allen used in municipal and public service district ("PSD") jobs did not qualify for the direct use exemption under W. Va. Code § 11-15-9(b)(2). But this Court should still reverse OTA's decision in part based on the following error:

> OTA erred by finding materials used to repair trucks moving finished limestone from J.F. Allen's crusher to the stockpile qualified for the direct use exemption to sales and use tax, W. Va. Code § 11-15-9(b)(2), when the trucks are not engaged in production, manufacturing, or any other activities that qualify for direct use treatment.

COUNTERSTATEMENT OF THE CASE

I. West Virginia's Sales and Use Tax System and its Exemptions.

West Virginia imposes a consumer sales and service tax "for the privilege of selling tangible personal property . . . and furnishing certain services" in-state. W. Va. Code § 11-15-3(a). It also taxes "the use in this state of tangible personal property," W. Va. Code § 11-15A-2(a), "when a good is sold from an out-of-state supplier for use in state." *Matkovich v. CSX Transp., Inc.*, 238 W. Va. 238, 243, 793 S.E.2d 888, 893 (2016) (cleaned up). Sales and use taxes are designed to be "complementary" and "whenever possible" "construed" together. *Preston Mem. Hosp. v. Palmer*, 213 W. Va. 189, 192, 578 S.E.2d 383, 386 (2003) (per curiam). For that reason, property that is "being used for [a] purpose" "exempt from the sales tax" under Article 15 of Chapter 11 of the Code is also exempt from the use tax. W. Va. Code § 11-15A-3(a)(2). One of these exempts "[s]ales of property or services to this state['s] . . . subdivisions[] [and] governmental units." W. Va. Code § 11-15-9(a)(3). Another exempts "[s]ales [or uses] of services, machinery, supplies, and materials directly used or consumed in the activities of manufacturing, transportation, . . . production of natural resources, . . . [or] provision of a public utility service or the operation of a utility service or the operation of a utility business." W. Va. Code § 11-15-9(b)(2).

II. J.F. Allen's Business Activities.

J.F. Allen a is multi-faceted corporation operating in Buckhannon, Elkins, and Saltwell, West Virginia. D.R.6. Its business includes limestone production, processing, and transportation, as well as construction work for municipalities and PSDs. *Id.*

In its limestone business, J.F. Allen uses three different types of trucks. *Id.* The first type hauls fifty to seventy-five (50-75) tons of the newly quarried limestone from the pit floor to a piece of processing equipment called a crusher. *Id.* Once the limestone is processed and manufactured at the crusher, it is then hauled by a second smaller truck (the piece of equipment at issue in the cross-assignment of error) to J.F. Allen's stockpile until it can be sold. *Id.* Once the limestone is sold to a prospective buyer, a larger third truck, that is suitable for travel on major highways, is loaded with the finished limestone and leaves J.F. Allen's quarry to deliver it to customers. *Id.*

J.F. Allen also performs jobs for municipalities and PSDs. These jobs often include digging ditches, laying necessary piping, filling trenches with appropriate fill material, and manhole installation. D.R.7. The jobs are typically awarded through a public bidding process. Petr's Br. 4. The bid identifies an estimate for labor, materials, equipment, fuel, and repair parts. *Id.* The parties agree that the entire bid amount and work performed by J.F. Allen is exempt from sales and use tax. D.R.10.

III. 2014 and 2021 Audits

In 2014, J.F. Allen was audited by the Tax Commissioner relating to tax years 2011 through 2013. D.R.7. At the conclusion of the 2014 audit, the Tax Commissioner found and informed J.F. Allen that it was calculating sales and use tax remittances incorrectly. *Id.* J.F. Allen protested this determination to OTA, but the parties eventually settled prior to any evidentiary hearing. D.R.189. J.F. Allen alleges that representatives of the Tax Commissioner agreed, as part of the settlement, that going forward it should take the equipment it purchased for repairs and maintenance on local

municipality and PSD jobs and apportion it based upon the time the equipment was used on "exempt" jobs versus "non-exempt" jobs to determine proper sales and use tax. D.R.7. The Tax Commissioner denies there is any direct evidence supporting this agreement on apportionment. From 2014 to mid-2021, J.F. Allen kept records of and apportioned the equipment it purchased for repairs and maintenance and paid only sales and use tax on the portion of the equipment utilized for non-exempt jobs. D.R.88-90, 184.

The Tax Commissioner then issued an audit notice of assessment against J.F. Allen on August 25, 2021, pursuant to W. Va. Code §§ 11-10-1 *et seq*. This assessment was related to combined sales and use tax for the period of January 1, 2018, through March 31, 2021, in the amount of $131,316.41, interest in the amount of $27,814.43, and additions to tax in the amount of $32,829.17, for a total tax liability of $191,960.01. D.R.6. The Tax Commissioner found that J.F. Allen under-collected and under-remitted sales and use tax due on purchases for repair and services on trucks used in the limestone operation and on equipment repairs consumed on municipality or PSD jobs. D.R.192, 313-322. The purchases at issue on the municipal and PSD jobs are supplies such as replacement hoses, belts, and bucket teeth. D.R.113.

IV. Procedural History

On October 15, 2021, J.F. Allen filed its *Petition for Refund* with OTA after paying the assessment. D.R.6. Prior to a hearing, the parties settled on a large portion of the assessment and issues unrelated to this appeal. D.R.7. But at the evidentiary hearing, J.F. Allen maintained that (1) $5,935.12 of the assessment improperly taxed materials used to repair the trucks it employed in its limestone production business; (2) another $7,886.09 improperly taxed materials used in its municipality and PSD jobs; and (3) the penalty and additions were not warranted because J.F.

Allen believed that it was following the guidance the Tax Commissioner gave it at the conclusion of its 2014 audit. D.R.6-7.

In its January 31, 2023, final order, OTA disagreed with J.F. Allen on the application of the direct use exemption to repair-materials used in municipality or PSD jobs. D.R.10-11. OTA found that this would give J.F. Allen a double exemption since the services it provides to municipalities and PSD is already exempt, D.R.10, and it found that J.F. Allen presented OTA with no authority for this double exemption. D.R.10-11. So, OTA upheld $7886.09 of the assessment related to repairs of municipal and PSD repair materials. D.R.15-17.

But OTA agreed with J.F. Allen on the rest. OTA held that $5,935.12 of the assessment was incorrect because it taxed materials used in repairs of trucks in J.F. Allen's limestone business. OTA reasoned that the entire business from the severing of limestone to its storage in J.F. Allen's stockpile would qualify as either production or manufacturing. D.R.11-12. So, it held that the use of materials to repair the trucks J.F. Allen used to haul finished limestone to the stockpile also qualified for the direct use exemption. D.R.11-17. OTA also rejected the Tax Commissioner's reliance on a contrary legislative rule because it was not mentioned at the evidentiary hearing. D.R.13. And because the direct use statute was unambiguous, it also found that "reliance on legislative rules is unwarranted." D.R.13. OTA also found that J.F. Allen did not intentionally disregard any West Virginia statutes or regulations nor was it negligent in underpaying its sales and use tax on repairs and maintenance to its equipment while performing contract work for local municipalities and PSDs. D.R.13-17.

J.F. Allen appealed the adverse parts of OTA's decision to this Court soon afterward. Then, on October 23, 2023, it filed its *Petitioner's Brief* arguing that OTA erred by concluding that the

direct use exemption did not apply to material used in the repair of equipment employed in municipality or PSD jobs. This Respondents Brief and Cross-Assignment of Error followed.[1]

SUMMARY OF THE ARGUMENT

I. OTA correctly upheld the $7,886.09 tax assessment related to repair and maintenance materials J.F. Allen used in municipality or PSD jobs. The taxpayer pointed to no legal basis for a double exemption allowing it to step into the shoes of the tax-exempt municipalities or PSDs. J.F. Allen calculates the repair costs in its original bid to municipalities and PSDs. Its entire bid and its charges to these government entities are exempt from sales tax. It cannot also receive a second exemption for equipment repair and maintenance expenses utilized on the tax-exempt service job. It is not a tax-exempt entity. The municipalities and PSDs it serves do not directly pay for the repair expenses, and J.F. Allen takes the repaired equipment with them after the job. J.F Allen has not presented any legal basis for allowing them to stand in the shoes of exempt government entities when it purchases materials to repair its equipment. OTA properly upheld the $7,886.09 tax assessment. This Court should do the same.

II. But OTA erred when it ruled that $5,935.12 of the assessment, which taxed materials for repairs and maintenance of trucks used on its limestone quarry site, was incorrect. The materials at issue were not directly used in either production or manufacturing activities as defined by the applicable statutes or rules. Rather, the taxed materials were used to repair trucks that move finished limestone from the crusher to the stockpile awaiting sale. But once limestone is severed from the earth, production of a natural resource ends. W. Va. Code § 11-15-2(b)(14)(A) & W. Va. Code R. §110-15-123.4.3. Once the limestone is crushed and fully processed, manufacturing of

[1] J.F. Allen's brief does not "open with a list of assignments of error" as required by Rule 10(c)(3) of the Rules of Appellate Procedures. But its Points and Authorities section addresses a single issue. Petr's Br. 6. This Respondent's Brief will respond to this issue to the fullest extent possible as if it was listed as an assignment of error. W. Va. R. App. P. 10(d).

this natural resource ends, too. W. Va. Code § 11-15-2(b)(24). The trucks at issue are simply transporting finished product from the crusher to the stockpile. True, certain transportation activities also qualify for the direct use exemption. W. Va. Code § 11-15-9(b)(2). But this activity only counts when it is performed as a "commercial enterprise," W. Va. Code § 11-15-2(b)(24), and "by a person engaged in the business of transport[ing]" "passengers or goods" "for others." W. Va. Code § 110-15-123.4.1. It "does not include the transportation of goods by the owner of the goods" such as "to a customer by the manufacturer" or "by the seller of the goods to the buyer." *Id.* J.F. Allen's movement of finished limestone from the crusher to the stockpile is not transportation as a "commercial enterprise" and is not "for others" because they own the limestone prior to sale. J.F. Allen's trucks are not engaged in transportation that qualifies under direct use, and the materials used to repair them also do not fall within the exemption. The materials, therefore, are subject to sales and use tax. The $5,935.12 assessment on these materials was proper, and OTA erred in ruling otherwise. This Court should reverse on this point.

STATEMENT REGARDING ORAL ARGUMENT

The Tax Commissioner requests Rule 19 oral argument because the assignments of error involve application of settled principles of law. W. Va. R. App. P. 19(a)(1), (4).

STANDARD OF REVIEW

The statutory and regulatory interpretation issues raised in this appeal "are questions of law" subject to "*de novo*" review by this Court. *Appalachian Power Co. v. State Tax Dep't*, 195 W. Va. 573, 581-82, 466 S.E.2d 424, 432-33 (1995). Otherwise, final decisions from OTA are reviewed under the standards set forth in the Administrative Procedures Act, W. Va. Code § 29A-5-4g. *See* Syl. Pt. 1, *Griffith v. Conagra Brands, Inc.*, 229 W. Va. 190, 191, 728 S.E.2d 74, 75 (2012). Its findings of fact should "not be set aside or vacated unless clearly wrong." *Id.* While "questions of law" are reviewed "*de novo*," its "interpretation of State tax provisions" should be

"be afforded sound consideration," *id.*, and "given great weight unless clearly erroneous." Syl. Pt. 2, *Keener v. Irby*, 245 W. Va. 777, 778, 865 S.E.2d 519, 520 (2021). Additionally, "[a]n inquiring court—even a court empowered to conduct *de novo* review—must examine a regulatory interpretation of a statute by standards that include appropriate deference to agency expertise and discretion." *Appalachian Power Co*, 195 W. Va. at 582, 466 S.E.2d at 433.

ARGUMENT

I. J.F. Allen's Purchases For Repair And Maintenance Of Equipment On Municipal And PSD Jobs Are Not Exempt From Sales And Use Tax.

OTA correctly upheld the $7,886.09 assessment related purchases of repair and maintenance materials J.F. Allen used in municipality or PSD jobs. J.F. Allen is not "provi[ding]" or "operat[ing]" "a public utility service" when it lays water and service lines, W. Va. Code § 11-15-9(b)(2), so it cannot qualify for the direct use exemption in its own right. And its contracting work for municipalities and PSDs does not shield its purchases either because these repair and maintenance materials are not left with the tax-exempt government entity. This Court should reject J.F. Allen's arguments for reversal and affirm OTA's decision on this issue.

A. J.F. Allen cannot independently qualify for the direct use exemption because it does not provide or operate a public utility. "[I]t is presumed that all sales and services are subject to the [sales] tax until the contrary is clearly established." W. Va. Code § 11-15-6(b). A similar presumption applies in the use tax system. W. Va. Code § 11-15A-18(c). Of course, J.F. Allen claims that it is entitled to the direct use exemption for purchases of supplies and materials used on jobs laying water and sewer lines for municipalities and PSDs. Petr's Br. 7-8. But it cannot claim this exemption in its own right.

To be sure, purchases of "services, machinery, supplies, and materials directly used or consumed" in "provision of a public utility service or the operation of a utility service" qualify for

the direct use exemption. W. Va. Code § 11-15-9(b)(2). But the definition section limits the application of this exemption to "the providing of" utility services "by a business subject to the business and occupation [B&O] tax imposed by" W. Va. Code § 11-13-2 and § 11-13-2d. *See* W. Va. Code § 11-15-2(b)(15). These B&O tax sections, in turn, apply to "person[s] engaging . . . in any public service or utility business," W. Va. Code § 11-13-2d(a), such as "[w]ater companies," *id.* § 11-13-2d(a)(2), or "[e]lectric light and power companies," *id.* § 11-13-2d(a)(3). But they do not apply to third party companies that perform construction work for public utilities. *Cf. Koppers Co., Inc. v. Dailey*, 167 W. Va. 521, 528, 280 S.E.2d 248, 252 (1981) (finding that the company engaged in construction work was "engaged in the business of contracting" for purposes of B&O tax). J.F. Allen does lay water and sewer lines for municipalities and PSDs. But it is not a public utility business, and it does not provide or operate a public utility service. Therefore, it cannot independently qualify for the direct use exemption for purchases related to public utility work.

B. J.F. Allen also cannot fit within the direct use exemption in any dependent capacity. To be clear, J.F. Allen does not argue for the direct use exemption based on its contractor status. In fact, OTA critiqued it for not presenting any legal basis for "step[ing] into the shoes of its exempt customer." D.R.10. Still, some construction contractors can assert a dependent entitlement when "the purchaser of [its] services . . . is entitled" to the direct use exemption. W. Va. Code § 11-15-8d(a). But J.F. Allen's purchases do not qualify for this treatment either because the materials it purchased do not remain with the public utility. Even if J.F. Allen claimed an exemption based on its contractor status, it would fail anyway.

Normally, "purchases by a contractor of tangible personal property . . . for use or consumption in the providing of a contracting service" are "taxable." W. Va. Code § 11-15-8a(a). "Persons who perform 'contracting'" services are [also] not allowed to "assert [most of the]

exemption" that "the purchaser of such contracting services" could qualify for. W. Va. Code § 11-15-8d(a). Instead, to qualify for an exemption "the tangible personal property or taxable service [must] actually [be] purchased by such [exempt] taxpayer and [] directly invoiced to and paid by such taxpayer." W. Va. Code § 11-15-8d(a).

But certain types of direct uses are carved out from these principles. For example, a construction contractor may be able to get a refund for the tax on "purchases" "directly used or consumed in the construction . . . of a new or existing building or structure" "if the purchaser of the contracting services would be entitled to" the direct use exemption on the same purchases. W. Va. Code § 11-15-8d(b). And the Tax Commissioner's interpretive rules extend this carve out to grant a per se exemption for purchases "directly used or consumed in the construction . . . of a new or existing public utility structure or system by a contractor." W. Va. Code R. § 110-15J-4.2.

Yet, this per se exemption does not help J.F. Allen. Of course, J.F. Allen is a construction contractor. Without a doubt, J.F. Allen performs contracted services for a public utility as defined in W. Va. Code R. §110-15J-3.3 because the jobs involve digging ditches, laying necessary piping, filling trenches with appropriate fill material, and/or manhole installation for municipalities and PSDs (government-owned or public service district water and/or sewer utilities). D.R.8. But the per se exemption only "applies to purchases . . . that remain on the construction site after the construction activity is completed." W. Va. Code R. § 110-15J-5.1. And it excludes "purchases of tools, bulldozers, cranes, etc. that become the property of the construction contractor . . . and are removed from the site after construction is completed." *Id.* § 110-15J-5.2.

The purchases at issue do not "remain on the construction site" as the rule requires. By J.F. Allen's own admission, these purchases are repair materials "like a blown hose" or a "replaced tooth" on a bucket that are affixed to J.F. Allen's equipment. Petr's Br. 5. Or they are "consumables

like oil and filters" for J.F. Allen's equipment. *Id.* And at best, these purchases only "stay[] with the PSD and municipality until the project is complete." *Id.* (emphasis added). They do not "remain on the construction site" after J.F. Allen leaves. W. Va. Code R. § 110-15J-5.1. Instead, J.F. Allen uses these materials to maintain and repair its equipment and then takes its equipment to other jobs for its own financial benefit.[2] OTA explained this scenario through the repair and utilization of a replacement hose. D.R.10-11 ("[T]he hose stays with Petitioner once the job is complete."). So, these purchases cannot qualify for the direct use exemption under W. Va. Code R. § 110-15J-5.1.

True, these limits on a public utility contractor's entitlement to the direct use exemption appear in an interpretive and not a legislative rule. And interpretive rules typically "do not create rights but merely clarify an existing statute or regulation." *Appalachian Power Co*, 195 W. Va. at 583, 466 S.E.2d at 434. Likewise, interpretive rules are normally "entitled on judicial review only to the weight that their inherent persuasiveness commands," *Antero Res. Corp. v. Irby*, No. 22-48 et al., 2023 WL 3964054, *3 (June 13, 2023) (mem. decision), but "do not have the force of law" like legislative rules. *Appalachian Power Co*, 195 W. Va. at 583, 466 S.E.2d at 434. Yet, one circumstance where an interpretive rule can be given greater weight is where the law "commits any decision or determination of fact or judgment to the sole discretion of any agency or any executive officer" and the interpretive rule identifies "the conditions for the exercise of that discretion." W. Va. Code § 29A-1-2(c). There, the interpretive rule can "establish[]" and "prove the conditions" in a "judicial proceeding" as long as "the conditions [for the exercise of agency discretion] are not prescribed by statute or legislative rule." *Id.*

[2] Although OTA criticized J.F. Allen for not identifying any "statutory or regulatory authority allow[ing] for [] apportionment," D.R.9, state law lets a purchase that "will use acquired" materials "for both exempt and nonexempt purposes" to "apportion[]" the "gross proceeds of" the sale "between the exempt and nonexempt uses, in a manner established as reasonable by the tax commissioner" to "determine the tax liability" on the purchase. W. Va. Code § 11-15-9e.

This limited circumstance arises with respect to this interpretive rule. Here, the Code gives the Tax Commissioner authority to "administer and enforce" the sale and use tax and to "make all needful rules . . . for the[se] taxes." W. Va. Code § 11-15-5. It also lets him "specify those exemptions authorized" under the sale and use tax codes that count as per se exemptions. W. Va. Code § 11-15-9m. That is exactly what he has done here. By interpretive rule, he has specified that contractor's purchases for public utility jobs are per se exempt, W. Va. Code R. § 110-15J-1.1, but he has clarified that this exemption only extends to purchases of materials that "remain on the construction site," W. Va. Code R. § 110-15J-5.1, and do not "become the property of the construction contractor" after the job is done, *id.* § 110-15J-5.2. The Tax Commissioner is well within his statutory discretion in clarifying these limits in this interpretive rule and this Court can rely on that rule to "establish[]" and "prove" the exercise of that discretion. W. Va. Code § 29A-1-2(c). J.F. Allen is not entitled to the per se direct use exemption under this rule and cannot assert an exemption that its municipality and PSD customers are entitled to.

This outcome is logical because if J.F. Allen were allowed to exempt its repair and maintenance expenses from sales and use tax while providing tax-exempt services to municipalities and PSDs, it would receive a double exemption. OTA pointed out this scenario and J.F. Allen's provided testimony that stated the exempt services were bid to the municipalities and PSDs and identified equipment utilized in the bid. D.R.9. J.F. Allen itself admits that it breaks down the job by labor, materials, equipment, fuel, and repair parts and uses historical knowledge to anticipate what will be needed on the job. Petr's Br., 4-5, 7-8 (Oct. 23, 2023); D.R.10, 108-119. So, the repair and maintenance expenses are calculated within the bid for services, charged to the municipalities and PSDs, and are exempt from sales and use tax. Based on statutory authority, regulatory authority, and common sense, J.F. Allen is not entitled to a sales and use tax exemption

on the same repair and maintenance supplies and materials for the equipment utilized on these municipality and PSD jobs because the municipalities and PSDs already paid for them.

J.F. Allen admittedly receives the municipalities' or PSDs' exempt purchases certificate when it is awarded the job. D.R.105. But when it uses this certificate to purchase materials that are later taken off the job site and used in other jobs, it is improper. The Tax Commissioner correctly assessed J.F. Allen $7,886.09 for these non-exempt purchases, and OTA rightly affirmed that assessment. D.R.16. This Court should affirm as well.

II. Purchases J.F. Allen Made To Repair Trucks That Hauled Finished Limestone To Its Stockpile Do Not Qualify For The Direct Use Exemption; OTA Erred By Ruling That They Were.

OTA was wrong to reverse the $5,935.12 assessment related to purchases of repair materials for trucks J.F. Allen used to haul finished, crushed limestone to its stockpile. These hauling activities are neither the production of natural resources—which by legislative rule ends when the limestone is severed from the ground—nor manufacturing. So, this activity does not fall within the direct use exemption, and the purchases related to these activities are not exempt from sales and use tax. OTA holding was contrary to the law and should be reversed.

The direct use exemption provides that "[s]ales of services, machinery, supplies, and materials directly used or consumed in the activities of manufacturing, transportation…production of natural resources…" are not subject to sales and use tax. W. Va. Code §11-15-9(b)(2). To be "directly used or consumed" in "manufacturing, transportation, . . . or the production of natural resources," a purchase must be "used or consumed in those activities or operations which constitute an integral and essential part of the activities." W. Va. Code § 11-15-2(b)(4). The purchases cannot be used in "those activities or operations which are simply incidental, convenient or remote to the activities." *Id.* Relevant to this matter, the "[u]ses of property or consumption of services"

constituting direct use "in the activities of manufacturing, transportation, . . . or the production of natural resources include" the maintenance and repair of property and equipment "directly used in transportation, . . . manufacturing production or production of natural resources." *Id.* § 11-15-2(b)(4)(A).

In contrast, "[u]ses of property or services" not constituting direct use "in the activities of manufacturing, transportation, . . . or the production of natural resources include" activities or functions "incidental or convenient . . . rather than an integral and essential part of these activities." *Id.* § 11-15-2(b)(4)(B). The production of natural resources, in relation to limestone, is "the performance [by the owner of the natural resources, or another]...of the act or process of exploring, developing, severing, extracting, reducing to possession and loading for shipment and shipment for sale." *Id.* § 11-15-2(b)(14)(A) and W. Va. Code R. § 110-15-123.4.3. The term manufacturing "means a systematic operation or integrated series of systematic operations engaged in as a business or segment of a business which transforms or converts tangible personal property by physical, chemical or other means into a different form, composition or character from that in which it originally existed." W. Va. Code § 11-15-2(b)(10). The term transportation "means the act or process of conveying, ***as a commercial enterprise***, passengers or goods from one place or geographical location to another place or geographical location." *Id.* § 11-15-2(b)(24).

OTA improperly found that in light of the aforementioned statutory language being clear, there was no ambiguity present and legislative rules relevant to and clarifying of the statutory definitions and exemption requirements could not be considered. D.R.13. However, the Tax Commissioner is empowered by statute to "make all needful rules . . . for the taxes" he enforces. W. Va. Code § 11-10-5. Thus, courts do not have to look for ambiguity in the statute(s) at issue to consider and apply the Tax Commissioner's consistent legislative rules. Notably, the Legislature

has expressly directed the Tax Commissioner to fill in the gaps in their statutes. *Id.* When he exercises this authority, his "legislative rules have the force and effect of law," *Murray Energy Corp. v. Steager*, 241 W. Va. 629, 638, 827 S.E.2d 417, 426 (2019), and those legislative rules "should be ignored only if the agency has exceeded its constitutional or statutory authority or it is arbitrary or capricious." *Id.* at 639, 827 S.E.2d at 427.

In *Appalachian Power* the high court stated:

> Our power to review the Tax Commissioner's decisions on policy grounds is extremely limited. We are not at liberty to affirm or overturn the Commissioner's regulation or decision merely on the basis of our agreement or disagreement with his policy implications, even when important issues of taxation are at stake.

195 W. Va. at 588, 466 S.E.2d at 439. Finally, this Court should "not set aside a formally adopted legislative rule without clearcut evidence of an inconsistency between the rule and the authorizing statute." *Id.* Rather, "an agency's interpretation will stand unless it is 'arbitrary, capricious, or manifestly contrary to the statute.'" *Id.* at 589, 466 S.E.2d at 440.

It was incorrect for OTA to first ask a question about ambiguity with regards to the statute(s) at issue and ignore related and relevant legislative rules. Instead, the first question in this analysis should be whether the legislative rules conflict with the relevant statute(s). Because the Tax Commissioner is provided deference through the promulgation of legislative rules and the discretion to clarify the requirements for exemption in the statute(s), this Court can look to on-point legislative rules elaborating what the phrases "production of natural resources," "manufacturing," "transportation," and "commercial enterprise" mean when applying the exemption. If there is no conflict with the relevant statute(s), the legislative rules are enforceable and cannot be ignored by this Court.

Pursuant to Tax Commissioner promulgated legislative rule W. Va. Code R. § 110-15-123.4.1, "[t]ransportation means the act or process of conveying, as a commercial enterprise by a

person engaged in the business of transportation, passengers or goods from one place or geographical location to another place or geographical location." This "transportation activity must be conducted for others as a commercial enterprise." *Id.* The activity "***does not include the transportation of goods by the owner of the goods, such as the transportation of goods to a customer by the manufacturer, or the transportation of goods by the seller of the goods to the buyer of the goods***..." *Id.* Additionally "***[t]ransportation also does not include storage of tangible personal property unless it is only temporarily stored while in transit.***" *Id.* Clearly, "purchases of tangible personal property or services not directly used in transportation [, as described above,] are subject to the sales and use tax." *Id.*

Here, OTA applied the direct use exemption under W. Va. Code §11-15-9(b)(2) to J.F. Allen's repair and maintenance expenses on the trucks moving finished limestone from the crusher to the stockpile. And it held that these expenses should be exempt from sales and use tax. OTA opined that this movement activity must be considered production of natural resources or manufacturing, which in turn triggers the direct use exemption. D.R.11-13. OTA also criticizes the Tax Commissioner for not advancing any arguments that directly dispute J.F. Allen engaging in the production of natural resource or that the repair and maintenance expenses at issue are directly used in the production of natural resources. D.R.11. OTA further admonishes the Tax Commissioner's late use of W. Va. Code R. § 110-15-123.4.3.3 and opined that this actually supports J.F. Allen's argument of direct use. D.R.11-12. According to OTA, these trucks must either be used in production of natural resources or manufacturing—either way materials purchased to repair them are exempt. D.R.11-12. But OTA acknowledged that once the finished limestone leaves the crusher and is moved to the stockpile, J.F. Allen could be engaged in some other, non-exempt activity. D.R.12. Admittedly, the Tax Commissioner never articulated what that

non-exempt activity was at OTA. However, he has consistently held the position that this non-exempt activity was subject to sales and use tax.

OTA's final decision was wrong on this issue for two reasons. First, J.F. Allen's repair expenses related to this activity of the trucks moving finished limestone from the crusher to the stockpile is neither production of natural resources nor manufacturing. Second, this movement activity could only be considered transportation under the direct use exemption, and J.F. Allen still cannot meet the rule requirements. Critically, W. Va. Code §11-15-2(b)(4)(A)(xi) notes that the "[m]aintaining or repairing of property, including maintenance equipment, directly used in transportation, communication, transmission, manufacturing production or production of natural resources" constitutes direct use. When looking at the direct use exemption in W. Va. Code §11-15-9(b)(2) as a whole, the repair and maintenance expenses are likely for machinery, supplies, and materials directly used or consumed in the use and movement of the trucks at issue.

Further, the only activities under the direct use exemption that could apply to this J.F. Allen scenario would be manufacturing, transportation, or the production of natural resources. J.F. Allen must show that its repair and maintenance expenses to the trucks in question constitute an integral and essential part of manufacturing, transportation, and/or the production of natural resources, as opposed to activities or operations which are simply incidental, convenient, or remote to the key activities listed. W. Va. Code § 11-15-2(b)(4)(B).

J.F. Allen conducts the production of natural resources when it severs and extracts limestone from the earth in West Virginia. J.F. Allen then has trucks that take the natural limestone to the crusher for processing. The specific severing and extraction process is exempt from sales and use tax because it is statutorily considered the production of natural resources. However, once the limestone is "severed and reduced to possession on the surface," the production of natural

resources ends and "any activity after the stone is severed" is not included. W. Va. Code R. §110-15-123.4.3.3.a. This legislative rule does not conflict with the statutory definition of "production of natural resources" under W. Va. Code § 11-15-2(b)(14)(A) ("the act or process of exploring, developing, severing, extracting, reducing to possession and loading for shipment and shipment for sale") and simply clarifies how the exemption should be applied. Additionally, statutory definition sections "for producers of natural resources" and severance tax drive home this point and make clear "'[s]evering' or 'severed' means the physical removal of the natural resources from the earth or waters of this state by any means…" and "[l]imestone or sandstone quarried or mined shall not include any treatment process or transportation after the limestone or sandstone is severed from the earth." W. Va. Code § 11-13A-2(c)(9)(B) & § 11-13A-2(c)(11). OTA erred in finding that the repair and maintenance expenses for the trucks that transport limestone after severing are directly used in the activity of the production of natural resources and exempt from sales and use tax.

Next, J.F. Allen performs a "systematic operation or integrated series of systematic operations… which transforms or converts limestone by physical, chemical or other means into a different form, composition or character from that in which it originally existed." W. Va. Code R. §110-15-123.4.2. This legislative rule does not conflict with the statutory definition of "manufacturing" under W. Va. Code § 11-15-2(b)(10) ("a systematic operation or integrated series of systematic operations engaged in as a business or segment of a business which transforms or converts tangible personal property by physical, chemical or other means into a different form, composition or character from that in which it originally existed") and mirrors it. Further, W. Va. Code R. §110-15-123.4.3.3.a notes that "[p]rocessing of limestone is considered to be manufacturing."

Once the crusher is utilized and "raw" limestone is "processed" and "transformed" into a finished product (i.e., a "different form") on the "last step of processing," the activity of manufacturing ends. W. Va. Code R. §110-15-123.4.2.1 ("[s]torage of completed products and transportation of completed products to the customer or to another site is not included in manufacturing"). Again, this legislative rule does not conflict with the statutory definition of manufacturing and should apply for clarification purposes. OTA erred in finding that the repair and maintenance expenses at issue for trucks that move the finished limestone from the crusher after processing could be considered in the activity of manufacturing and exempt from sales and use tax.

Admittedly, the use of purchases in transportation activities may also qualify for the direct use exemption. But J.F. Allen is not engaged in the type of transportation identified in the statute and rule. When J.F. Allen's trucks move finished limestone from the crusher to the stockpile awaiting sale, J.F. conducts an action or the process of conveying goods from "one place or geographical location to another place or geographical location." W. Va. Code R. § 110-15-123.4.1. However, J.F. Allen must conduct this action or process of conveying the limestone as a "commercial enterprise" for it to be considered transportation. The phrase "commercial enterprise" is undefined in the statute and needs clarification to properly apply the exemption.

Critically, W. Va. Code R. § 110-15-123.4.1 provides the missing context and makes clear that "commercial enterprise" does not include transportation of goods by the owner of said goods, such as the transportation of the goods to the customer by the manufacturer. This legislative rule simply clarifies what "transportation" is for the purpose of the exemption and does not conflict with W. Va. Code § 11-15-2(b)(24). It has been established by the parties and OTA in this matter that J.F. Allen is the manufacturer of the finished limestone by way of the crusher. D.R.11-13.

Until J.F. Allen sells and delivers the finished limestone to the customer, it is the owner of the finished limestone. J.F. Allen stores the finished limestone at the stockpile while it awaits sale. This storage is not temporary while in transit to the customer. J.F. Allen's trucks at issue are clearly not conducting transportation as a commercial enterprise as described by W. Va. Code R. § 110-15-123.4.1. Therefore, by both statutory and regulatory authority, the activity of J.F. Allen's trucks moving finished limestone from the crusher to the stockpile is not transportation under the direct use exemption. So, the purchases of machinery, supplies, and materials directly used or consumed in the repair and maintenance of J.F. Allen's trucks at issue are subject to the sales and use tax.

The trucks at issue that are moving finished limestone from the crusher to the stockpile do not qualify as the production of natural resources, manufacturing, or transportation. So, purchases of material to repair and maintain them do not qualify for the direct use exemption, W. Va. Code § 11-15-9(b)(2), and they are subject to the sales and use tax. OTA erred in invalidating the $5,935.12 assessment on these repair and maintenance purchases. This Court should reverse OTA's decision on this point and restore the assessment.

CONCLUSION

For the foregoing reasons, the Tax Commissioner respectfully requests that that OTA's decision to uphold the $7,886.09 assessment for purchases related to municipality and PSD jobs be affirmed but that its decision to invalidate the $5,935.12 assessment for purchases related to repairs on trucks used to haul finished limestone to the stockpile be reversed.

Respectfully submitted,

MATTHEW IRBY, STATE TAX COMMISSIONER OF WEST VIRGINIA,

By Counsel,

PATRICK MORRISEY

ATTORNEY GENERAL

Sean M. Whelan (WVSB # 12067)
Deputy Attorney General
Kevin C. Kidd (WVSB # 13642)
Assistant Attorney General
State Capitol Complex
Building 1, Room W-435
Charleston, West Virginia 25305
Email: Sean.M.Whelan@wvago.gov
Kevin.C.Kidd@wvago.gov
Telephone: (304) 558-2522
Facsimile: (304) 558-2525

IN THE INTERMEDIATE COURT OF APPEALS OF WEST VIRGINIA

NO. 23-ICA-327

J.F. ALLEN COMPANY,

Petitioner Below, Petitioner,

v.

MATTHEW R. IRBY, STATE TAX COMMISSIONER OF WEST VIRGINIA,

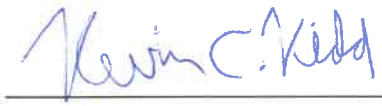
Respondent Below, Respondent,

On Appeal from the West Virginia Office of Tax Appeals,
Docket No. 21-169 (A.M. "Fenway" Pollack, Chief ALJ)

CERTIFICATE OF SERVICE

I, Kevin C. Kidd, do hereby certify that on this 7th day of December 2023, the foregoing "*Respondent's Brief and Cross-Assignment of Error*" of Matthew Irby, State Tax Commissioner of West Virginia, was electronically filed with the Clerk of the Court using the File & Serve Express system, which will send notification of such filing to the following:

Floyd M. Sayre, III, Esq.
Bowles Rice LLP
101 South Queen Street
Post Office Drawer 1419
Martinsburg, WV 25402
Counsel for Petitioner



Kevin C. Kidd
Assistant Attorney General